RECENT EFFORTS TO REDUCE INTERPROVINCIAL TRADE BARRIERS

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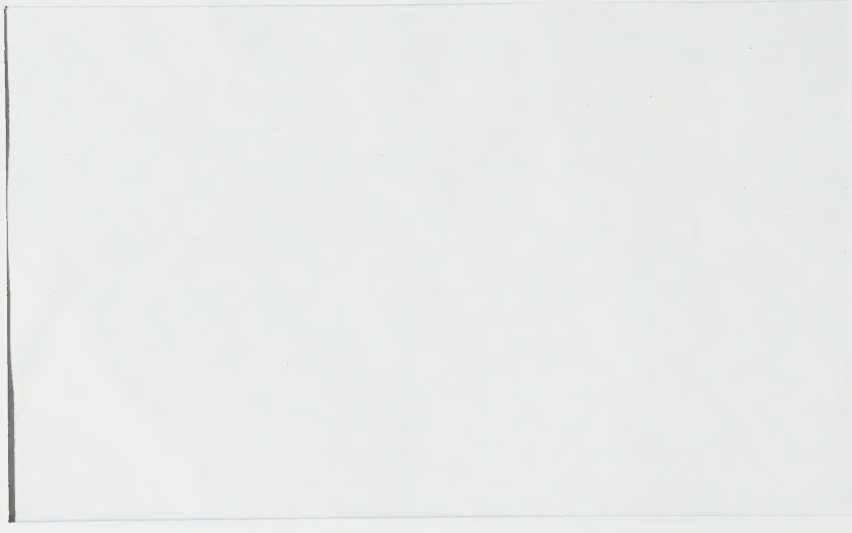

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INTRODUCTION

Internal trade barriers within federal countries vary depending on the degree of decentralization of powers. For Canada, one of the more decentralized federations in the world, internal trade barriers have been a significant economic and political issue. Although tariff barriers are prohibited under the Constitution Act, 1867, non-tariff barriers still frustrate the free movement of persons, goods and services, and capital. Common internal barriers include technical standards, occupational qualifications, incentives and subsidies, supply management systems and preferential government procurement policies. One 1990 business study estimated that some 500 inter-provincial trade barriers cost the economy $6.5 billion.

This paper examines the issue of interprovincial trade barriers in Canada. It begins by providing the context of the interprovincial trade scene: the volume of interprovincial trade in Canada, the methods to calculate the costs of trade barriers and the costs of the trade barriers themselves. The paper then reviews the latest federal-provincial initiative to tackle trade barriers; the July 1994 Agreement on Internal Trade.

CANADIAN INTERPROVINCIAL TRADE

The most recent federal statistics show that interprovincial trade totalled $141 billion in 1990, almost as much as the $161 billion in international exports.[1] The number of jobs which are linked to interprovincial trade is about 1.7 million compared with 1.6 million for international trade.[2] Ontario and Quebec are each others' largest customers with sales between the two provinces exceeding $20 billion in each direction in 1990. [3]

To put these trade figures into perspective, Canadian interprovincial trade in 1988-89 was 20.1 times larger than Canada-U.S. trade when accounting for size and distance.[4] For example, given that California's GDP is 10 times as large as B.C.'s and that the distance to market from Quebec is similar, the value of trade between Quebec and California could be expected to be 10 times the value of trade with B.C. In fact, the value of Quebec-B.C. trade is 2.6 times as great as Quebec-California trade.[5]

These data demonstrate that interprovincial trade is a major component of Canada's well-being. Many have argued that trade barriers frustrate a higher standard of living and possibly international competitiveness. Removing or reducing them would better the lives of Canadians.

The Costs Of Interprovincial Trade Barriers

Trade barriers have been a long-standing problem in Canada. Over the decades, provinces have used three main types of barriers to protect local businesses. The first consists of laws, regulations, or other kinds of policies that overtly discriminate against goods and services from outside the home province: examples include procurement policies which favour local bidders, and wine and beer distribution schemes. The second type of barrier is caused by administrative measures that are overly complex and by differing regulations and standards. The last type of barrier is more subtle and concerns attempts to influence the location of economic activity - usually investment - through various incentives.

Many studies have attempted to put a cost on these trade barriers. One of the more prominent examples is a 1990 Canadian Manufacturers Association (CMA) study which identified about 500 barriers and estimated their costs at $6.5 billion: $5 billion resulting from unfair preferential government procurement, $1 billion from agricultural trade barriers and $500 million from beer and wine trade barriers. (Barriers in beer and wine trade - notably provincial laws requiring beer companies to build brewing and bottling facilities in each province - produced a balkanized, inefficient brewing industry. These trade barriers were a major contributor to the recent foreign takeovers in the Canadian brewing industry.[6])

Another way of expressing the costs of interprovincial trade barriers noted above is that they add up to almost 1% of Canada's GDP of roughly $700 billion or about $1,000 per year for a family of four.

The CMA study, which received considerable press coverage, came under attack by some analysts. A review of the study by one economist revealed a "simplistic and conceptually flawed" methodology.[7] In particular, the $5 billion cost attributed to government procurement assumed an across-the-board 5% local bidding premium awarded to all contracts, which the study placed at $100 billion per year.† However, a true accounting of economic costs should be conducted on a "net basis," requiring analysts to not only factor in the costs of the premium but to also net out the benefits to local suppliers. Such an analysis was not conducted in the CMA study.[8]

Other trade analysts, such as Daniel Schwanen with the C.D. Howe Institute, state that "there is nothing implausible about the often-cited

†Government in the past often gave local businesses a margin of between 3-5% or higher enabling them to be competitive with more efficient businesses outside the province.

figure of 1 percent of GDP." [9] For one thing, studies often focus solely on the costs attributable to trade in goods whereas many significant trade barriers occur in the service sector or labour mobility. Furthermore, most studies concentrate on the costs of trade barriers in terms of inefficient allocation of resources, while ignoring the dynamic costs - the penalties that successful companies suffer, such as achieving economies of scale and possibly greater international competitiveness, because trade barriers reward less efficient firms.[10]

THE AGREEMENT ON INTERNAL TRADE

Background

Attempts to reduce trade barriers in Canada have a long and somewhat ignoble history. In 1937, the Royal Commission on Dominion-Provincial Relations, otherwise known as the Rowell-Sirois Commission after its two prominent chairmen, called for the abolition of internal barriers, including those restricting trade and commerce, investment, mobility and the practice of a trade or profession, and discriminatory taxation.[11] More recently, the Macdonald Commission, appointed in 1982 and reporting in 1985, proposed the establishment of a national Code of Economic Conduct to spell out policies that would strengthen the economic union, and a federal-provincial Council of Ministers for Economic Development to implement it. As part of these measures, provincial governments would be asked to justify existing barriers, and then each barrier would be considered in this context.

Following the Macdonald Commission, numerous committees were established to consider ways of reducing barriers to trade, including specialized committees to consider individual sectors such as trucking. One notable example was a federal-provincial task force that made the following recommendations at the meeting of Economic Development Ministers in June 1986:

- adopt a moratorium on new barriers, subject to compelling consideration of provincial economic development;
- establish a permanent mechanism at the federal-provincial level to reduce existing barriers;
- establish an inventory of existing barriers; and
- establish a set of guiding principles for reducing barriers.[12]

At the meeting of Regional Economic Development Ministers in October 1986, a Committee of Ministers was established to reduce trade barriers. Following the 1987 Annual Conference of First

Ministers, the Committee was reconstituted as the Committee of Ministers on Internal Trade.

Another impetus to reducing trade barriers in the 1980s resulted from the constitutional negotiations sparked by the unity crisis with Quebec. Along with negotiations over distribution of powers, Ottawa and the provinces engaged in discussions on interprovincial trade barriers. For instance, the 1992 Consensus Report on the Constitution (Charlottetown Accord) set out economic policy objectives that Canada's First Ministers agreed to include in the constitution, notably working together to strengthen the Canadian economic union and the free movement of persons, goods, services and capital.[13]

Although the Charlottetown Accord was not ratified, movement towards many of its policy objectives such as internal free trade continued. Negotiations on the Agreement on Internal Trade (AIT) began in March 1993 and culminated in July 1994 with the signing of the agreement by the federal government and the provinces. The agreement took effect July 1995.

An Overview of the Agreement on Internal Trade

The AIT is essentially composed of four major areas:

- Operating principles and objectives;
- General rules;
- Policy areas or "chapters" in the wording of the agreement; and
- Institutions designed to monitor and implement the agreement.

In terms of policy areas, there are 11 chapters in the agreement: government procurement, investment, labour mobility, consumer related measures and standards, agricultural and food goods, alcoholic beverages, natural resources processing, energy, communications, transportation and environmental protection. This paper examines in detail the following six: government procurement, investment, labour mobility, agriculture, alcoholic beverages and energy. These policy areas have the most significant economic impact or have long been seen as interprovincial trade irritants.

Operating Principles and Objective

The overall objective of the AIT is to "reduce and eliminate, to the extent possible, barriers to the free movement of persons, goods, services, and investments within Canada, and to establish an open,

efficient and stable domestic market." Accordingly, the AIT is composed of the following major principles:

- the AIT applies to trade only within Canada;
- new barriers will not be erected by the governments;
- persons, goods, services and investments will be treated equally by governments, regardless of origin in Canada (the so called non-discrimination principle);
- future policies by the governments will be compatible with the agreement;
- governments will inform one another of policies that could act as a trade barrier (the so-called transparency principle); and
- the agreement will not impede regional development objectives of the governments.

These major principles are consistent with those found in many international trade agreements.

General Rules

There are six major general rules in the AIT.

1. *Article 401 - Reciprocal Non-discrimination* is modelled after the "Most-favoured-nations" principle embodied in many international trade treaties. In essence the rule states that signatories will give the same treatment to goods and services from outside the province as they do to goods and services from within their own province.

2. *Article 402 - Right of Entry and Exit* states that governments will not adopt or maintain measures which restrict or prevent the free flow of persons, goods, services, and investments across their provincial boundaries.

3. *Article 403* obliges governments to ensure that any new measures it adopts or maintains does not create an obstacle to internal trade.

4. *Article 404 - Legitimate Objectives* gives the provinces and the federal government the right to develop or maintain trade barriers so long as

- the measure is designed to achieve a "legitimate objective" (such as regional development);
- the measure does not "impair unduly" trade access;
- the measure is not more trade restrictive than necessary to achieve the objective; and
- the measure does not create a disguised restriction on trade.

5. *Article 405 - Reconciliation* states that governments will reconcile standards and standards-related measures by harmonization, mutual recognition or other means.

6. *Article 406 - Transparency* obliges governments to inform one another of measures that may act as a trade barrier.

The rules, like much of the AIT itself, are modelled after provisions in many international trade treaties. For example, article 404 reflects a recognition that parties are free to adopt domestic policy measures that have a legitimate purpose.

The rules of non-discrimination and transparency represent solid achievements of the AIT. It should be noted, however, that each of the 11 chapters in the AIT specifies which rules apply and which do not. For instance, the rule of Freedom of Entry and Exit does not apply to alcoholic beverages, meaning that beer and wine are still subject to archaic provincial legislation. This is particularly significant since trade barriers in alcoholic beverages constitute one of the largest interprovincial trade barriers.

In addition, the wording of article 401 "Reciprocal non-discrimination" suggests that non-discrimination is not a blanket rule per se but a selective rule which the provinces intend to barter in negotiations with other provinces possessing trade barriers.

Giving governments the right to erect trade barriers as long as they are in the name of "legitimate objectives" appears to be a shortcoming of the agreement. However, trade experts suggest that the criteria which must be met before a policy objective can be labelled as legitimate are stringent enough to prevent abuse. As with most of this agreement, time will tell how governments interpret and implement this rule.

Chapter Five: Procurement

Chapter Five, Procurement is the most comprehensive and possibly the most important chapter of the agreement. As the table below demonstrates, $50 billion is spent each year by governments and the broader public sector (BPS).

Estimates of Public Sector Procurement Spending By Level of Government
Goods, Services & Construction (1992, $ Billions)

Level	Canada	Ontario	Other Prov.
Total Fed. Expend. In Prov. *	$10	$3[14]	$7
Total Provincial *	$15	$6	$9
Total Broader Public Sector**	$25	$10	$15
Total Public Sector	$50	$20	$30***

* The spending by federal Crown corporations are not included.
** School boards, hospitals, municipal governments, universities, etc.
*** Rounding and estimates.
Source: Estimates based on National Accounts and Trade Policy Estimates

Article 504 obliges governments to apply reciprocal non-discrimination to procurement. Ontario used to allow a 10% premium on many contracts for local suppliers and gave preference to Ontario companies when bids were competitive and British Columbia used to allow a 10% price premium to local suppliers. The Macdonald Royal Commission estimated the cost of trade barriers in government procurement at $100 million.[15]

Article 506 obliges the parties to standardize procedures for procurement. Until the agreement took effect, governments were free to use whatever methods they wanted in the tendering process; under the AIT, signatories will centralize electronic tendering on one system if they use electronic tendering[16], centralize tendering in one newspaper if they use the print media, and centralize in one source list if they use various source lists.[17]

Under article 507, trade rules in the chapter *do not* apply to the following:

- procurement of goods intended for resale to the public;
- procurement of goods, services or construction on behalf of an entity not covered by the chapter;

- procurement from philanthropic institutions, prison labour or persons with disabilities;

- procurement contracts between entities listed in the Annexes [Prominent examples are listed on the following page];

- procurement of goods, services or construction purchased for representational purposes outside the territory of a party; and

- procurement of any goods the interprovincial movement of which is restricted by laws not inconsistent with the Agreement.[18]

As well, under article 508, signatories are free to develop or maintain procurement barriers in the aim of regional development, so long as they are consistent with the criteria outlined under article 404, Legitimate Objectives. Procurement of services from professional organizations are also exempted from the AIT until the provinces reconcile occupational qualifications and standards contained in chapter seven on labour mobility.

Article 511 obliges the parties to report annually to each other aggregate data on the value of procurement contracts while articles 513 and 514 establish procedures in the event of bidding protests by suppliers. Article 516 obliges the governments to meet in July 1996 to review and assess Chapter 5.

Overall, the provinces made clear achievements with non-discrimination, bidding protest procedures, and the efforts at standardizing the tendering procedures. Perhaps more importantly, it sets in motion a number of processes, reviews and negotiations to ensure procurement barriers are eliminated or kept down.[19]

Unfortunately, there is a long list of Crown Corporations that were exempted from the agreement, including prominent corporations such as Hydro Quebec, Caisse de depot et placement du Quebec, Saskatchewan Power Corporation, SaskEnergy Incorporated, New Brunswick Power Corporation, BC Hydro, BC Rail, Insurance Corporation of BC, the Bank of Canada and the Canadian Space Agency. It should be noted that the governments undertake to "negotiate" by June 30, 1996 to "reducing, modifying or amending the list" so that the exempted entities will either comply with the agreement or the governments will take a non-interventionist or "hands-off" approach by not directing the agencies to pursue local or provincial concerns.

Although there appears to be a movement towards centralizing procurement tendering on the federal government's Open Bidding System and making other electronic tendering systems compatible with it, the ideal goal of a "one window" access for tendering appears to be a distant one. The technical challenges of establishing a one-window system seem daunting enough, but one must also consider that a wide cross section of suppliers from across the country will need to be informed about using such an electronic tendering system if governments hope to develop an active, competitive bidding system. Although the AIT may spur the creation of a more robust electronic tendering system in the short-term, a truly effective system will be a longer-term and more costly objective.

Chapter Six: Investment

One of the key achievements of this chapter is article 604 which abolishes local presence and residency requirements that governments have imposed on businesses in the past. Likewise, article 607 eliminates performance requirements such as local content requirements. However, the chapter qualified the latter by still allowing governments to make businesses meet requirements on economic development or employment before receiving incentives.

Another notable achievement is the Code of Conduct on Incentives. This complex annex outlines the guidelines that governments must follow in attracting or maintaining investment. Determining the exact nature of "incentives" is always tricky, but the AIT defined them as:

- a contribution with a financial value that confers a benefit on the recipient, including cash grants, loans, debt guarantees, or an equity injection, made on preferential terms;

- a reduction in government taxes or levies otherwise payable aimed at a specific enterprise, whether organized as one legal entity or as a group of legal entities, but does not include a reduction resulting from a provision of general application of a tax law of a party; or

- any form of income or price support that results directly or indirectly in a draw on the public purse.

It is the last criteria which is problematic. The purpose of such a vague criteria may have been to cast a wide net for abuse of investment incentives, but its practical effect may end up being to cover an unintended assortment of government policies.

Interestingly enough, while incentives may not be used to entice investment away from other provinces, the signatories are allowed to use them to protect investments from being lured outside the country.

Measures inconsistent with the AIT but allowed in the pursuit of "legitimate objectives" are permissible. Municipalities are free to employ incentives (such as lowered property taxes) since they are exempted from the AIT, and privatization of government enterprises and assets or services are not subject to the AIT.

On a related note, the most disappointing aspect of the investment chapter is that financial institutions were not tackled; Quebec vetoed any progress to protect its unique system of Caisse populaires credit unions and securities-based firms. As a result, the rules and regulations regarding corporate securities across the country remains a jumbled mess. There is also no movement on rectifying this situation.

Chapter Seven: Labour Mobility

Although personal mobility is guaranteed under section 6 of the Constitution Act, 1982, the free movement of labour faces a number of restrictions. Provincial law authorizes professional associations to license and regulate practitioners, which normally includes restrictions on entry, rules of conduct, fees, etc., and as such tends to vary from province to province. As a result, these practices frequently discriminate against individuals from other provinces. The most recent dispute in this area concerned the rights of construction workers in Ontario and Quebec to work in the adjoining province. The 1993 dispute, which broke out in the Ottawa-Hull region, concerned Quebec's regulation requiring construction companies doing business in Quebec to have a Quebec head office. In the face of retaliation by Ontario, Quebec backed down late in 1993 and scrapped the rule.[20] A formal agreement between the two provinces concerning the mobility rights of construction workers was then signed.

The labour mobility chapter in the AIT addresses barriers created by occupational standards, licensing, certification, registration and residency requirements.

Article 706 prohibits the provinces from requiring workers of another province to be a resident in its territory as a condition of licensing, certification, registration, or eligibility for occupation while article 707 obliges the parties to ensure that regulations of employment do

not constitute a barrier to movement but relate principally to competence.

In order to implement this chapter, article 712 provides that the Forum of Labour Market Ministers (a periodic meeting of provincial and federal ministers) work to

- develop a work plan for the implementation of the obligations of the Parties under this Chapter;
- coordinate the implementation of the work plan; and
- produce an annual report of the operation of this Chapter and submit it to the Committee on Internal Trade.

According to trade analysts Michael Trebilcock and Rambod Behboodi of the C.D. Howe Institute, "Chapter seven unambiguously requires mutual recognition of occupational standards among parties with highly comparable standards. Moreover, it exhorts the parties that have no standards to develop them in such a way as to facilitate reconciliation, including where none of the parties has implemented standards in a given field."[21] However, Trebilcock and Behboodi also question the effectiveness of chapter seven. First of all, the Forum of Labour Market Ministers "apparently must operate on a consensus unanimity basis in negotiating harmonized or minimum standards or reservations from these standards. This seems merely to be old-style executive federalism dressed up in a new name."[22] Moreover, "it is difficult to imagine that the Forum of Labour Market Ministers could actually issue legally binding directives to provinces requiring them to adjust particular labor market standards that fall within their constitutional jurisdiction if the parties themselves are not willing to make such changes."[23]

Chapter Nine: Agriculture

Most Canadians are familiar with supply management and marketing boards in dairy, chicken, eggs and turkeys, but perhaps not many realize that the costs of interprovincial trade barriers in agriculture are surprisingly low - less than $500,000 as estimated by the Macdonald Royal Commission.[24] The costs of international trade barriers on the other hand are quite another story but outside the purview of this paper. What should be noted, however, is that any liberalization of the agricultural supply management system on an interprovincial basis must also be offered to the United States and Mexico under the North American Free Trade Agreement. Such an obligation makes it

unlikely that changes to the supply management system will come first from interprovincial negotiations.

The agriculture chapter does not address the quotas adopted by supply management or marketing boards across the country, but rather applies only to measures identified as technical barriers to trade by the Federal-Provincial Agri-Food Inspection Committee.

Under article 903, the parties commit themselves to working together to reduce or eliminate barriers in agricultural and food products. As well, the provinces are committed to ensuring that their sanitary measures do not arbitrarily or unjustly discriminate between parties where identical or similar conditions prevail.

A major achievement of the agriculture chapter is the establishment of processes to begin the arduous task of reviewing, identifying and reducing agricultural trade barriers in the country. One of the major vehicles through which discussions will take place is the Federal-Provincial Agricultural Trade Policy Committee, composed of assistant deputy ministers and/or department managers.

Chapter Ten: Alcoholic Beverages

Reducing interprovincial trade barriers in alcoholic beverages is important for two reasons: archaic and protectionist provincial regulations have resulted in economic losses of almost $500 million[25], one of the largest trade barrier costs, and secondly, it is one of the most visible trade barriers for the general public.[26] The Brewers' Association, in a brief to the federal government leading up to free trade talks, characterized the industry as follows:

> The fact that the licencing of the manufacturing establishments is a federal government authority while control of the sale and distribution of the product is under provincial control has led to a heavy burden of regulations, a high degree of overlap and consequently the development of an industry that has been based, at least to a significant degree, on political priorities and dictates other than purely economic business judgement.[27]

Article 1004 states that reciprocal non-discrimination applies to listing, pricing, access to points of sale, distribution, merchandising and cost of service, fees and other charges. Article 403 (No Obstacles to internal trade) is restated here in article 1005 and applies

specifically to regulations and requirements in administrative procedures and decisions, labelling and packaging, oenology and advertising.

"Non-conforming measures" or exceptions include:

- Newfoundland reserves the right to deny the sale of out-of-province beer. The decision will be reviewed before the end of the decade;

- Nova Scotia reserves the right to maintain differential floor pricing mechanisms for beer and beer products from provinces other than from Nova Scotia and New Brunswick; and

- Ontario maintains the right to apply its Canadian grape content requirements but will review these requirements before the earlier of July 1, 1996 or the adoption of the Canadian Wine Standards by the grape and wine industries.

Other loopholes to the AIT include the following:

- Ontario and B.C. retain the right to require private wine store outlets to discriminate in favour of Ontario and B.C. wine;

- Quebec may require any wine sold in grocery stores to be bottled in Quebec, provided that alternative outlets are provided in Quebec for the sale of wine from other provinces, whether or not such wine is bottled in Quebec; and

- the provinces may maintain or introduce measures limiting sales of alcohol by producers where it is produced on the premises.

The biggest shortcoming to the chapter is that article 402 of the AIT - the Right of Entry and Exit - does not apply to alcoholic beverages, meaning that free movement of beer and wine across Canada is still elusive.

Chapter Twelve: Energy

A chapter on energy was not concluded by the time the agreement was signed because Newfoundland and Quebec could not agree on the issue of wheeling electricity. In layman's terms, wheeling is an arrangement whereby a utility agrees to distribute electricity from a third party generator. For example, Ontario Hydro could agree to distribute electricity generated by Manitoba Hydro to a pulp and

paper mill in Quebec. Newfoundland, on behalf of its provincial electrical utility, demanded access to the Hydro Quebec electrical grid to wheel electricity, thereby enabling Newfoundland Hydro to escape from, among other things, the punishing Churchill Falls agreement, a long-term deal guaranteeing low electricity prices for Quebec from Newfoundland Hydro. For its part, Ontario was silent but leaned to Quebec's side on wheeling since Ontario Hydro is fearful of losing its sales monopoly on electricity to both domestic power producers and, more importantly, U.S. utilities.

Although other aspects of the energy chapter were concluded, in the end, Newfoundland refused to ratify the chapter until a deal is reached on wheeling. As a result, the energy chapter was bypassed and interprovincial negotiations are continuing.

Chapter Sixteen: Institutional Provisions

The AIT established three institutions to implement and monitor the agreement: the Committee on Internal Trade, the Working Group on Adjustment and the Secretariat.

The Committee on Internal Trade

The Committee on Internal Trade is designed to supervise the implementation of the AIT and assist in the resolution of disputes. It will be composed of cabinet-level representatives who will be responsible for drawing up much of the Committee's practices and procedures. The Committee is to meet annually or more often if determined necessary. Each province will alternate as Chair of the Committee, determined by drawing lots each year. Decisions by the Committee will be based on consensus.

Daniel Schwanen, a senior policy analyst at the C.D. Howe Institute, argues that consensus decision-making may become an obstacle to removing trade barriers. A better approach would be a European Union-style, two tier voting mechanism in which consensus is used to decide matters of principle and majority voting is used for matters of implementation.[28]

However, according to one Ontario government official, there is disagreement about the definition of consensus. Consensus may not always mean unanimity, at least not behind closed negotiating doors.[29]

The Working Group on Adjustment

The Working Group on Adjustment is charged with examining the effects of the AIT on the provinces each fiscal year. The Working Group, composed of representatives from the provinces and Ottawa, will meet semi-annually or more often if need be and will report annually to the Committee. The Working Group may make recommendations, where necessary, on enabling the governments to adjust the AIT. The Working Group will be dissolved by April 1, 2006 or at such time agreed to by the Committee.

The Secretariat

The Secretariat is the main workhorse of the Committee: it has the mandate to provide administrative and operational support to the Committee and other committees as directed. The Secretariat, to be located in Winnipeg, will possess a budget of $800,000 per year and a staff of five. Ottawa will pay 50% of the Secretariat's budget while the provinces will contribute the remainder (Ontario's portion will be 25% of the provincial total).

Such a small staff may be ill equipped to monitor effectively the agreement and consequently the Secretariat may be forced to rely on responsible ministries across the country. One government official agreed that the Secretariat was purposely enfeebled because of a fear the federal government was making a grab for provincial powers and that Ottawa would use the institution to its advantage. This was also the reason for locating the Secretariat in Winnipeg.[30]

The lack of an effective bureaucracy charged with implementing and monitoring the agreement means the provinces must provide the impetus to tackle trade barriers. Governments will "feel an obligation to comply whether or not they have a legal ability to do otherwise," states University of Toronto Law Professor Katherine Swinton.[31] Other analysts such as Trebilcock and Behboodi are more cautious. They assert: "Whether the Committee on Internal Trade ... will provide sufficient central direction and focus to the enterprise is an open question."[32] Moreover, they are concerned that many areas of the AIT lack a clear fallback rule to which the Secretariat would default in the event of deadlock.

The analysts might also be concerned that approximately one-quarter of the AIT provisions with deadlines had been missed as of late fall 1995. Examples include requirements that each province name a roster of panellists for the bidding protest procedures associated with government procurement by July 1, 1995; that the provinces review

and finalize the list of professional and trade services that were excluded from the chapter on government procurement by July 1, 1995; and that the provinces complete coverage of government procurement to include the broader public sector including hospitals, universities, school boards and municipal organizations by June 30, 1995. Whether the original deadlines were too ambitious or whether the provinces were not assigning a high priority to implementing the agreement remains unclear.

Chapter Seventeen: Dispute Resolution Procedures

A key feature of the AIT is the dispute settlement mechanism (DSM); a set of rules and procedures to help resolve interprovincial trade disputes. Architects of the AIT designed the DSM in a layered fashion: to start with, the parties are compelled to discuss and negotiate their dispute. Each chapter of the AIT provides for dispute avoidance and resolution processes - essentially consisting of consultations and negotiations by both parties. These processes must be exhausted before the complaining party can proceed to take the dispute to the more formal court-like adjudication in the DSM.

Once the dispute is taken before the DSM, the parties can either request the assistance of the Committee on Internal Trade or the creation of an independent five member panel whose responsibility is to review, investigate and report on the dispute. All governments are to maintain a list of potential panellists.

In the event that a province decides to ignore the findings of a panel report - which is non-binding - the Secretariat has the option of making the panel report public, thereby increasing the pressure on the offending province to rectify its position. Should the glare of public attention fail to move the province, the offended province will be free to take retaliatory measures equal to the effect of the trade barrier.

The DSM also contains procedures for "individuals," in essence companies, to make claims against a province. If a company believes that it is being harmed by a provincial measure, the company must first consult with its provincial government and secure its cooperation in forwarding the dispute. If the province agrees that a company has a legitimate case, then procedures discussed above would apply. If, however, the home government denies the case, the company must either drop the case or appeal to a screener (each province must appoint a screener for appeals). The decision of the screener is final: if a case is determined to be legitimate, it proceeds to the DSM; if the case is determined to be illegitimate, it is dropped.

The AIT's dispute settlement mechanism is a definite achievement of the agreement. Governments had no such recourse in the past and the fact that the negotiators allowed for persons to challenge governments is an achievement that other countries do not have.

From a legal perspective, taking retaliatory measures "if they are aimed at interprovincial trade, would clearly be *ultra vires* for the province that takes them."[33] From an economic perspective, resorting to retaliatory actions would be futile for smaller provinces in the Maritimes or Prairies when confronting Quebec and Ontario.

Perhaps another troubling aspect is the lack of openness in the DSM process. With the exception of proceedings before the DSM panel, which must be held in public, the whole process is carried out in secret. Many negotiators believe that confidential negotiations are conducive to resolving conflicts. But if one accepts that suasion is the engine of the DSM, then openness and publicity is the fuel. One has to ask whether governments should be the sole decision makers on trade issues or whether the Canadian public should also be allowed to participate.

Conclusions

The Agreement on Internal Trade has its supporters and detractors. In the latter camp is Armand de Mestral, a law professor at McGill University. He states that, with the exception of chapters five and six (procurement and investment), "this document fails utterly to do what it claims to do."[34] De Mestral states that

> the governments chose the General Agreement on Tariffs and Trade as their model for the agreement. This model, and a 1960s version at that, is a "least common denominator," unfitting for a federal country like Canada which should aspire to stronger bonds of integration.

De Mestral, like many lawyers, is critical that the AIT is a political agreement rather than one rooted in constitutional law, thereby allowing governments to bend agreements when it suits their own needs. Similarly, an Ontario trade negotiator argued that because the AIT is a political document and not a legal one, the foundation for implementing the agreement and making further progress rests with the will of the provinces. Should a province decide to ignore the AIT or one of its panel reports, the agreement could unravel.[35]

In the same vein, Prof. de Mestral states that loopholes abound in the agreement - the ability to pursue legitimate objectives and/or regional development are the most significant examples - which are inconsistent with the aims of reducing trade barriers. A clear shortcoming is the failure to tackle financial institutions, in particular, the area of securities legislation. And as already mentioned, de Mestral argues that the dispute settlement mechanism is flawed since a province taking retaliatory action in the realm of interprovincial trade would clearly be ultra vires.

Another commentator, University of Toronto Economist Albert Breton, questions the benefits of the "sacred icons" of standardization and harmonization. First of all, economic integration generally means a loss of choice in the marketplace, the cost of which has generally not been measured by economists. Secondly, there are political costs as well. "Except in trivial polar cases, there is, therefore, a genuine tradeoff between the requirements of economic integration and those of federalism."[36] Although provinces may have differing legislation and regulations, which on the surface appear to constitute trade barriers, their costs are often minimal. The Macdonald Commission also acknowledged that sometimes important "social and cultural goals may justify government intervention that directly or indirectly affect the free movement of factors."[37]

Prof. Breton also warns that if the goods and services that have non-verifiable characteristics are not excluded from the agreement, they have the potential to become deal-breakers.[38]

Another conclusion some observers have drawn is that the agreement applies to Canadian entities, meaning a sovereign Quebec would not enjoy the trade liberalizing benefits of the agreement. From an economic standpoint, however, it is less clear that trade agreements such as the AIT would no longer be in force after separation. Business interests in both Quebec and the rest of Canada could be unnecessarily harmed by a sudden interruption in trade. Politicians, recognizing such an outcome, may opt to leave agreements such as the AIT alone and ignore Quebec's "foreign country" status.

Meanwhile, supporters such as Daniel Schwanen believe that the agreement represents a significant achievement. Schwanen would rate the agreement highly in terms of comprehensiveness, non-discrimination, mutual recognition of standards, the code of conduct on incentives and the dispute settlement mechanism.[39] He noted that the governments still have a lot of work to do in implementing the agreement and in continuing the process, but recognized that all the provinces are living up to the letter and spirit of the agreement. For

example, the expansion of the agreement to include the broader public sector within the provisions under the chapter on procurement is taking place.

Overall, the Agreement on Internal Trade is a solid achievement, albeit with some shortcomings. Beyond its specific provisions, the AIT can be seen as the beginning of a major process to eliminate or reduce interprovincial trade barriers.

To some degree, the Agreement on Internal Trade was probably inevitable. Most Canadian governments recognize the harm of internal protectionism and have been under increasing pressure to address this issue. More broadly, international trade agreements and competition are a powerful constraint on any provincial government's protective instincts.

NOTES

[1] Canada, Statistics Canada, "Interprovincial trade and the structure of the provincial economies, 1990," *The Daily* (Ottawa: Supply and Services, 2 June 1995), p. 3.

[2] Ibid.

[3] Ibid.

[4] John McCallum and John F. Helliwell, *The extraordinary trade-generating powers of the Canadian Economic Union* ([Canada: Royal Bank], May 1995), p. 4.

[5] Ibid., p. 3.

[6] Labatt is owned by Interbrew, a Belgium brewing concern, and Molson is owned by the Australian Fosters and a U.S. brewer.

[7] British Columbia, Ministry of Economic Development, Small Business and Trade, and Brian R. Copeland, *Interprovincial barriers to trade: A review of the empirical evidence from a British Columbia perspective* ([Vancouver]: The Ministry, [1993]), p. 11.

[8] Ibid., pp. 11-13. Interestingly enough, Copeland concludes that the "available evidence suggests that the aggregate efficiency cost of federal and provincial policies which interfere with interprovincial trade is likely to be quite small as a fraction of GNP," p. 34. Copeland does not, however, provide a final cost figure to back up this assertion.

[9] Daniel Schwanen, "One Market, Many Opportunities: The Last Stage in Removing Obstacles to Interprovincial Trade," *C.D. Howe Institute Commentary* (March 1994): 6.

[10] Ibid.

[11] Canada, Royal Commission on Dominion-Provincial Relations (Newton Rowell and Joseph Sirois, Chairmen), *Report of the Royal Commission on Dominion-Provincial Relations*, Vol. 2 (Ottawa: The King's Printer, 1940), p. 67.

[12] Ontario, Ministry of Industry, Trade and Technology, "Statement by the Honourable Hugh P. O'Neil, Minister of Industry, Trade and Technology, on Interprovincial Trade Barriers and Estimates," *Press Release*, 12 February 1987.

[13] For a discussion of recent government efforts to reduce trade barriers, see Rob Nishman, *Interprovincial Trade Barriers and Constitutional Reform*, Current Issue Paper No. 130 (Toronto: Legislative Research Service, October 1992).

[14] Of the $3 billion, the largest spenders were: MTO $857 million, Government Services $620 million, MNR $260 million, NDM $$165 million and MOH $150 million.

[15] Kenneth Norrie, Richard Simeon and Mark Krasnick, *Federalism and economic union in*

Canada (Ottawa: Minister of Supply and Services Canada, 1986), p. 242.

[16] It appears that governments are centralizing or becoming compatible with the federal government's Open Bidding System.

[17] More than 90% of the Ontario government's procurement, excluding construction, is tendered electronically.

[18] Canada, Agreement on Internal Trade (Ottawa: Internal Trade Secretariat, 1994), Article 507, pp. 25-26.

[19] The achievements in government procurement are timely because beginning 1 January 1996, a new multilateral Agreement on Government Procurement came into force. The agreement, which was signed by Canada, supplants the one that was negotiated during the Tokyo Round of talks under the General Agreement on Tariffs and Trade in force since 1981. Among the more significant provisions, the new agreement on government procurement obliges signatories to revise tendering procedures and extends coverage to a wide range of services, both of which will have implications for provincial governments.

[20] Randy Boswell, "Ontario-Quebec barrier tumbles for builders," *Ottawa Citizen*, 25 August 1995, p. B6.

[21] Michael J. Trebilcock and Rambod Behboodi, "The Canadian Agreement on Internal Trade: Retrospect and Prospects," in Michael J. Trebilcock and Daniel Schwanen, eds., *Getting there: an assessment of the agreement on internal trade* (Toronto: C.D. Howe Institute, 1995), p. 62.

[22] Ibid., p. 63.

[23] Ibid.

[24] Norrie, Simeon and Krasnick, *Federalism and Economic Union in Canada*, p. 245.

[25] Copeland, p. 9.

[26] Having to travel to the U.S. to buy Moosehead beer - which is brewed in New Brunswick - was an example often cited by Canadians.

[27] Canada, Ministry of International Trade, *Brief on "Perspectives on Canada-United States Free Trade" in response to "How to Secure and Enhance Canadian Access to Export Markets"* (Ottawa: Brewers' Association of Canada, May 1985), pp. 1-2.

[28] Telephone interview with Daniel Schwanen, Senior Policy Analyst, C.D. Howe Institute.

[29] Telephone interview with Stephen de Boer, Policy Advisor, Trade Relation Policy Branch, Ministry of Economic Development, Trade and Tourism.

[30] Ibid.

[31] Katherine Swinton, "Law, Politics, and the Enforcement of the Agreement on Internal Trade," in

Getting There, p. 209.

[32] Trebilcock and Behboodi, "The Canadian Agreement on Internal Trade," in *Getting There*, p. 85.

[33] Armand de Mestral, "A Comment," in *Getting There*, p. 97.

[34] Ibid., p. 95.

[35] Telephone interview with Stephen de Boer.

[36] Albert Breton, "A Comment," in *Getting There*, p. 91.

[37] Canada, Royal Commission on the Economic Union and Development Prospects for Canada, *Report*, Vol. 3 (Ottawa: Supply and Services, 1985), pp. 135-136.

[38] Albert Breton, "A Comment," in *Getting There*, p. 93.

[39] Telephone interview with Daniel Schwanen. On a 10 point scale, for instance, Schwanen would give the agreement a "midterm grade of 8.5."